Annual Report 1974

McCrory Corporation

DIRECTORS

***ISIDORE A. BECKER**
President of Rapid-American Corporation; Chairman of the Board of Schenley Industries, Inc. (wholly-owned subsidiary of Rapid-American Corporation); Vice Chairman of the Board of McCrory Corporation

PATRICK J. CLIFFORD
Director of Security National Bank
Director of Triangle Pacific Forest Products Corp. (Home Bldg. & Wood Products)
Director of Masters, Inc. (discount stores)

BERNARD KOBROVSKY
Private Investor

***STANLEY H. KUNSBERG**
President of McCrory Corporation

***HAROLD M. LANE, SR.**
Chairman of the Board of Lerner Stores Corporation

***HAROLD M. LANE, JR.**
President and Chief Executive Officer of Lerner Stores Corporation

LEONARD C. LANE
Executive Vice President of Rapid-American Corporation

SAMUEL J. LEVY
Chairman of the Board of Southern Packaging & Design Corp. (woven labels)

***BERT R. PRALL**
President of McCrory Credit Corporation; Director of The Chicago-Tokyo Bank

***MESHULAM RIKLIS**
Chairman of the Board and Chief Executive Officer of Rapid-American Corporation and McCrory Corporation

PINHAS RIKLIS
Chairman of the Board of Garay & Co., Inc. (ladies' handbags and belts)

***JULIUS SANDITEN**
Executive Vice President of McCrory Corporation

***LORENCE A. SILVERBERG**
Executive Vice President of McCrory Corporation

***LEONARD SPANGENBERG**
Chairman of the Executive Committee of McCrory Corporation; Director of The Babson Organization, Inc. (Holding Company)

OFFICERS

STANLEY H. KUNSBERG
President

HAROLD M. LANE, JR.
Executive Vice President

CHARLES GASS
Vice President

MESHULAM RIKLIS
Chairman of the Board and Chief Executive Officer

LORENCE A. SILVERBERG
Executive Vice President

IRWIN MAYER
Vice President & Treasurer

SEYMOUR GREENE
Secretary

ISIDORE A. BECKER
Vice Chairman of the Board

JULIUS SANDITEN
Executive Vice President

ELY G. SANDITEN
Vice President

COMMITTEE CHAIRMEN

LEONARD SPANGENBERG
Executive Committee

BERNARD KOBROVSKY
Salary and Compensation Committee and Audit Committee

STANLEY H. KUNSBERG
Stock Option Committee and Management Stock Bonus Committee

**Member of Executive Committee*

To Our Stockholders:

This past year was a difficult one for retailing in the United States. The deteriorating economy, characterized by soaring interest rates, increasing inflation, a high level of unemployment and the lack of consumer confidence, brought about a major slow down in consumer spending which led to depressed operating results throughout the industry.

In financial terms, the year was disappointing. Sales and income from continuing operations were $1,281,700,000 and $2,581,000, respectively, in the year ended January 31, 1975, as compared to $1,256,832,000 and $18,485,000, respectively, in the prior year. The poor results of the S. Klein department stores more than offset the operating earnings of McCrory. During 1974, S. Klein had a loss from operations of approximately $8.2 million after taxes. Because of this division's drain on earnings, our Board of Directors has accepted management's recommendation to provide for anticipated losses, as of January 31, 1975, relating to the complete phase-out of the operations of S. Klein.

Accordingly, a provision of $31.5 million (after related Federal income tax benefit) mainly for estimated losses to be incurred in connection with this program has been established in the 1974 financial statements. The elimination of the Klein's operation is expected to have a positive effect on future earnings.

Lerner Shops and OTASCO Stores performed well and reported approximately the same earnings in each of the last two years.

We were successful in closing our Canadian variety store chain which had operated at a loss. In addition, in February 1975 we sold for cash the Sweet Sixteen division in Canada which specialized in women's apparel.

The results of the Variety Stores division, comprised of McCrory, McLellan, H. L. Green and J. J. Newberry stores, were not satisfactory. As a result, we have reorganized and restructured management, and instituted a vigorous program to reduce inventory levels, eliminate unprofitable stores and make substantial expense reductions. These continuing programs should restore the Variety Stores division to a profitable operation in 1975.

In November 1974, a new two year revolving credit agreement was signed with nine major banks and the F.D.I.C. under which McCrory may borrow up to $110,250,000.

In March and April of this year, the Boards of Directors of McCrory and Rapid-American Corporation, respectively, announced that they had approved in principle the merger of McCrory with a wholly-owned subsidiary of Rapid-American on the basis of one-half of a share of Rapid-American common stock for each share of McCrory common stock. Rapid-American is presently the owner of approximately 62% of the outstanding shares of McCrory common stock. The proposed merger is subject to consent of bank lenders to both companies, the preparation of definitive agreements, proxy material and a registration statement and stockholder approval. The proxy material that you will receive prior to the special merger meeting will contain considerable additional information. Our annual meeting of stockholders, usually held on the fourth Tuesday in May, will consequently be postponed and combined with the special merger meeting to permit us to submit the proposed merger to a vote of stockholders. The date of the combined meeting will be announced as soon as possible.

Despite last year's disappointing results, we are facing the future with hope and confidence.

Sincerely,

M. Riklis

MESHULAM RIKLIS
Chairman of the Board

Stanley H. Kunsberg

STANLEY H. KUNSBERG
President

April 30, 1975

BRIEF DESCRIPTION OF BUSINESS OPERATIONS

McCrory Corporation is a broadly based retailing organization. At January 31, 1975, it operated 1,023 variety stores in the United States under various names, including "McCrory", "McLellan", "H. L. Green" and "J. J. Newberry"; a chain of 225 company-owned and 336 franchised retail automotive and home accessories stores under the name "OTASCO Stores"; a chain of 28 "Britts" department stores; 457 retail stores, operating under the name "Lerner Shops", specializing in the sale of women's and children's apparel; and, in Canada, 32 "Harrison's" fabric stores and "Gault Brothers", principally a manufacturer of leisure wear and a distributor of hotel-motel supplies. Since the beginning of this past fiscal year, McCrory has taken various steps to dispose of certain of its operations. These steps have included the closing or disposal of all of its 25 United Stores, a variety store chain in Canada, four Britts department stores in Canada, the sale of all of its 82 Sweet Sixteen stores in Canada and, in the United States, the complete phasing out of its S. Klein department stores.

The following tables set forth the percentage contribution to the revenues and operating profit of McCrory of each major line of business during each of the last five years. Operations which are treated as discontinued, including the operations of S. Klein, are excluded.

	Year Ended January 31,				
	1975	1974	1973	1972	1971
Revenues [1]:					
Variety Stores	39.1%	41.2%	39.2%	35.2%	37.2%
Britts Department Stores	5.5	5.8	4.5	—	—
Apparel Specialty Stores	39.6	38.0	41.9	50.3	49.5
Automotive and Home Accessories Stores	11.8	11.3	12.2	14.5	13.3
Other	4.0	3.7	2.2	—	—
	100%	100%	100%	100%	100%
Operating profit (loss) [1 and 2]:					
Variety Stores	(3.8)%	22.3%	27.3%	29.7%	32.1%
Britts Department Stores	1.2	4.1	4.5	—	—
Apparel Specialty Store	77.7	57.7	52.2	53.2	53.4
Automotive and Home Accessories Stores	24.3	15.8	15.0	17.1	14.5
Other	.6	.1	1.0	—	—
	100%	100%	100%	100%	100%

[1] Operations of Newberry are included only from September 1, 1972, the date of acquisition. Due to the seasonal nature of Newberry's operations, the sales and operating profit of Newberry for the five months ended January 31, 1973 represent approximately 48% and 144%, respectively, of the amount of Newberry's sales and operating profit which would have been included in such table for the year ended January 31, 1973 had the acquisition of Newberry occurred on February 1, 1972.

[2] For purposes of the table, operating profit (loss) has been determined before deducting interest, debt expense, income taxes and minority interests and excludes allocation of corporate office expenses to operating units.

Consolidated Statement of Operations

	Year Ended January 31 1975	1974
	(In Thousands, Except Per Share Amounts)	
Revenues:		
Sales	$1,281,700	$1,256,832
Other—net	4,439	4,633
	1,286,139	1,261,465
Costs and Expenses:		
Cost of goods sold	887,529	855,407
Selling, advertising, general and administrative expenses	328,598	317,587
Interest and debt expense	45,393	33,896
Depreciation and amortization	14,801	13,663
Federal income taxes (including deferred taxes of $1,857,000 and $4,631,000)	2,652	16,509
State income taxes	2,585	2,752
Income applicable to minority interest	—	3,166
	1,281,558	1,242,980
Income From Continuing Operations Before Item Set Forth Below	4,581	18,485
Provision for loss on investments	2,000	—
Income from continuing operations	2,581	18,485
Loss from discontinued operations	(8,173)	(4,977)
Provision for loss in 1975 on phase-out of discontinued operations and, in 1974, write-off of excess of cost of investment over related equity	(31,500)	(11,907)
Net Income (Loss)	(37,092)	1,601
Consolidated preferred dividend requirements	1,145	1,160
Net Income (Loss) Applicable to Common Stock	$ (38,237)	$ 441
Earnings (Loss) Per Share of Common Stock:		
Primary:		
Continuing operations	$ .28	$3.42
Discontinued operations	(7.83)	(3.33)
Net income (loss)	$(7.55)	$ .09
Fully Diluted:		
Continuing operations	*	$3.17
Discontinued operations	*	(3.15)
Net income (loss)	*	$ .02

* Anti-dilutive

See Schedule and Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

ASSETS	January 31 1975 (In Thousands)	January 31 1974
Current Assets:		
Cash (including certificates of deposit $11,025,000 and $185,000)	$ 31,871	$ 8,814
Receivables, less allowances ($2,987,000 and $2,558,000)	18,004	20,947
Merchandise inventories	196,382	257,424
Prepaid expenses, etc.	7,450	9,245
Net assets held for sale	4,992	—
Net assets held for disposal	2,487	—
Total Current Assets	261,186	296,430
Investments in and Advances to:		
Rapid-American Corporation	1,621	3,621
McCrory Credit Corporation	16,346	15,358
	17,967	18,979
Property and Equipment:		
Furniture and fixtures and leasehold improvements	281,063	326,368
Store properties, warehouses and leased facilities	27,559	26,903
	308,622	353,271
Less accumulated depreciation and amortization	184,732	205,676
	123,890	147,595
Other Assets:		
Excess of cost of investment over related equity	60,484	61,795
Long-term receivable	6,256	6,628
Net assets held for disposal	9,453	—
Deferred future Federal income tax benefits	2,586	—
Sundry	10,375	15,561
	89,154	83,984
	$492,197	$546,988

See Schedule and Notes to Consolidated Financial Statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	January 31 1975 (In Thousands)	1974
Current Liabilities:		
Bank loans	$ 14,200	$ 24,326
Current maturities of long-term debt	2,862	2,834
Accounts payable	42,513	71,256
Accrued expenses and sundry	49,555	54,011
Federal income taxes:		
Current	—	1,831
Deferred	—	9,645
Reserve for store closing programs	15,808	2,500
Total Current Liabilities	124,938	166,403
Long-Term Debt	287,213	258,961
Deferred Federal Income Taxes	—	21,204
Reserve for Store Closing Programs	26,975	9,553
Other Long-Term Liabilities	14,750	9,747
Minority Interest in Subsidiary	3,579	3,593
Stockholders' Equity:		
Preferred and preference stocks	15,711	15,712
Common stock, $.50 par value, authorized 15,000,000 shares	4,201	4,201
Additional paid-in capital	94,082	94,101
Retained earnings	31,339	74,128
Less common stock in treasury at cost	(110,591)	(110,615)
	34,742	77,527
	$492,197	$546,988

See Schedule and Notes to Consolidated Financial Statements.

Consolidated Statement of Stockholders' Equity

For the Two Years Ended January 31, 1975

	(In Thousands)						
	Preferred and Preference Stocks	**Common Stock Issued**		**Additional Paid-In Capital**	**Retained Earnings**	**Common Stock in Treasury**	
		Shares	Par Value			Shares	Cost
Balance February 1, 1973	**$15,744**	**8,399.8**	**$4,200**	**$99,616**	**$100,250**	**3,364.9**	**$120,859**
Common stock issued:							
Conversion of 320 shares of preferred stock	(32)	1.6	1	31			
Exercise of stock options					(375)	(17.7)	(585)
Purchase of 1,600,485 warrants				(5,778)	(10,727)		
Net income					1,601		
Dividends:							
Preferred and preference stock					(850)		
Common stock ($1.20 per share)					(6,047)		
Equity in retirement of Lerner common stock in treasury				(97)	(9,409)		(9,506)
Equity in certain transactions of subsidiaries				331	(310)		(128)
Other—net		.6		(2)	(5)	(.6)	(25)
Balance January 31, 1974	**15,712**	**8,402.0**	**4,201**	**94,101**	**74,128**	**3,346.6**	**110,615**
Common stock issued:							
Conversion of 10 shares of preferred stock	(1)	.1		1			
Net loss					(37,092)		
Dividends:							
Preferred and preference stock					(849)		
Common stock ($.90 per share)					(4,552)		
Equity in certain transactions of subsidiary				8	(296)		
Other—net				(28)		11.9	(24)
Balance January 31, 1975	**$15,711**	**8,402.1**	**$4,201**	**$94,082**	**$31,339**	**3,358.5**	**$110,591**

See Schedule and Notes to Consolidated Financial Statements.

Consolidated Statement of Changes in Financial Position

	Year Ended January 31	
	1975	1974
	(In Thousands)	
Source of Funds		
Operations:		
Net income (loss)	$(37,092)	$ 1,601
Charges (credits) not requiring (providing) funds:		
Provision for loss on phase-out of discontinued operations	37,477	—
Provision for loss on investments	2,000	—
Write-off of excess cost	—	11,907
Depreciation and amortization, etc.	18,048	15,935
Deferred income taxes	(22,843)	4,299
Reduction of reserve for store closing programs as a result of reappraisal	—	(1,915)
Debt expense	3,362	2,242
Stock bonus plan expense	392	629
Income applicable to minority interest, less cash dividends of $823,000	—	2,343
Funds provided from operations	1,344	37,041
Increase in long-term debt—Credit Agreement	31,700	—
Increase in other non-current liabilities	5,860	—
Debentures issued for Lerner minority interest	—	73,481
Property and equipment disposals	1,825	1,329
Sale of Sweet Sixteen Division	1,740	—
Proceeds on exercise of options and warrants	—	552
	$42,469	$112,403
Application of Funds		
Additions to property and equipment	$ 18,899	$22,246
Dividends paid	5,697	7,207
Acquisition of Lerner minority interest	691	92,416
Purchase of warrants	—	16,505
Reductions of other long-term debt	8,167	3,857
Deferred systems development costs	—	3,163
Deferred income taxes	947	498
Reduction of non-current reserve relating to store closing program	885	—
Advance to McCrory Credit Corporation	800	600
Other-net	162	(373)
Increase (decrease) in working capital	6,221	(33,716)
	$42,469	$112,403
Increase (Decrease) In Working Capital by Components:		
Cash	$23,057	$(42,711)
Receivables—net	(2,943)	3,922
Merchandise inventories	(61,042)	20,949
Prepaid expenses, etc.	(1,795)	(151)
Net assets held for sale or disposal	7,479	—
Bank loans	10,126	(17,224)
Current maturities of long-term debt	(28)	(831)
Accounts payable	28,743	(1,238)
Accrued expenses and sundry	4,456	(2,870)
Federal income taxes	11,476	6,438
Reserve for store closing programs	(13,308)	—
Increase (decrease) in working capital	$ 6,221	$(33,716)

See Schedule and Notes to Consolidated Financial Statements.

Consolidated Long-Term Debt

	Interest Rate Stated	Interest Rate Effective	January 31 1975 (In Thousands)	January 31 1974 (In Thousands)
Sinking fund notes of Newberry due 1976(a)	3¾%	3¾%	$ 2,500	$ 3,000
Sinking fund subordinated debentures, due 1976(b)	5½	6⁶⁄₁₀	11,357	11,357
Junior sinking fund subordinated debentures, due 1981(c)	5	5	10,527	11,106
Subordinated notes of Newberry, payable $1,033,000 annually to 1981	5¼	5¼	6,203	7,236
Sinking fund subordinated debentures of Lerner, due 1982(d)	6½	8⁷⁄₁₀	8,521	8,822
Sinking fund subordinated debentures, due 1985(e)	10½	11³⁄₁₀	10,392	11,239
Convertible subordinated debentures, due 1992(f)	6½	6⁹⁄₁₀	3,380	3,380
Sinking fund subordinated debentures, due 1994(g)	7½	9½	70,388	70,388
Convertible subordinated debentures of Newberry, due 1994(h)	6½	6½	1,132	1,142
Sinking fund subordinated debentures, due 1995(i)	7¾	12¹⁄₁₀	108,860	115,152
Sinking fund subordinated debentures, due 1997(j)	7⅝	9⁸⁄₁₀	63,926	63,824
Notes payable to banks under Revolving Credit Agreement(k)			52,000	20,300
Sundry			2,214	1,731
			351,400	328,677
Less unamortized discount			64,187	69,716
			$287,213	$258,961

(a) Sinking fund payments in the amount of $500,000 required annually through 1975 with the balance of $2,500,000 payable May 15, 1976.

(b) All sinking fund requirements have been met.

(c) Exclusive of $370,000 and $718,000 at January 31, 1975 and 1974, respectively, which have been reacquired and are available for sinking fund payments. Annual sinking fund requirements are $649,000.

(d) Sinking fund requirements in each year based on original principal amount ($10,025,000) are as follows: 1975-1976 (3%), 1977-1979 (4%), and 1980-1981 (5%).

(e) Exclusive of $255,000 at January 31, 1975 which has been reacquired and is available for sinking fund payments. Annual sinking fund requirements are $592,000.

(f) Convertible into McCrory common stock at the option of the holder at the conversion price of $30 principal amount of debentures per share to and including February 14, 1977 and $35 thereafter.

(g) Required annual sinking fund payments commence in 1981.

(h) Convertible into Newberry common stock at the option of the holder at the conversion price of $30 principal amount of debentures per share.

(i) Exclusive of $15,646,000 and $15,029,000 at January 31, 1975 and 1974, respectively, held by Lerner and $1,404,000 at January 31, 1975 which has been reaquired and is available for sinking fund payments. Sinking fund requirements in each year based on original principal amount ($130,211,000) are as follows: 1975-1979 (3%), 1980-1983 (4%), 1984-1989 (5%) and 1990-1995 (6%).

(j) Required annual sinking fund payments commence in 1984.

(k) On November 26, 1974 McCrory entered into a Credit Agreement (the "Credit Agreement"), as amended, with nine banks (the "Banks") and the Federal Deposit Insurance Corporation ("FDIC")

aggregating $110,250,000 to meet cash requirements as necessary. At January 31, 1975, there were $65,000,000 of notes outstanding ($13,000,000 included in Bank loans in current liabilities) and $45,250,000 of unused lines of credit available. McCrory borrows money evidenced by 90-day promissory notes except that the loan of the FDIC in the amount of $7,000,000 is payable on June 30, 1976.

Interest under the Credit Agreement (11.45% at January 31, 1975) on loans up to an aggregate of $65,000,000 is at the rate of the higher of 1% above 110% of the prime rate of Chemical Bank or 1½% above 110% of the commercial paper rate (as defined) on an annual basis; on loans in excess of $65,000,000, the interest rate is the higher of 110% of the prime rate or ½ of 1% above 110% of the commercial paper rate on an annual basis. The Credit Agreement also provides for a commitment fee of ½% per annum on the average unused portion of the committed lines.

To secure the loans, McCrory granted to the Banks and the FDIC security interests in (i) all of the outstanding stock of its Lerner subsidiary, (ii) a demand note of Newberry in the principal amount of $41,500,000 payable to McCrory and (iii) certain accounts receivable of McCrory payable by Newberry. McCrory's obligations under the Credit Agreement are guaranteed by substantially all of its subsidiaries, other than Newberry and McCrory Credit and their subsidiaries.

The maximum of notes payable to banks and the FDIC outstanding at any month-end during the year ended January 31, 1975 was $121,500,000. The average amount of notes payable to banks and the FDIC outstanding during the year was approximately $102,000,000 (calculated as the average of the month-end borrowings outstanding). The interest rate applicable to such loans ranged from 10.5 to 12.6% and the weighted average interest rate on such debt was approximately 12.4% (calculated by dividing the interest expense for such borrowings by the above borrowings).

In connection with the Credit Agreement, informal arrangements require maintenance of compensating balances averaging 10% of the total line of credit. The average daily bank balances on deposit with various Banks having a credit relationship with McCrory during the period November 26, 1974 to January 31, 1975 were approximately $22,000,000.

The Credit Agreement replaced a $70,000,000 revolving credit agreement as well as short-term lines of credit, aggregating $51,500,000, of certain consolidated subsidiaries. At January 31, 1974, there were $43,000,000 of notes outstanding ($22,700,000 included in current liabilities). During the year ended January 31, 1974, the maximum and average borrowings outstanding were $114,446,000 and $70,672,000, respectively. The interest rate applicable to such loans ranged from 6 to 10%, and the weighted average interest rate on such debt was approximately 8.9%.

See Note 9 to Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(1) Accounting Policies

Significant accounting policies of McCrory are as follows:

The accounts of all subsidiaries except McCrory Credit Corporation, which is carried on the equity basis, are included in the consolidated financial statements. Accounts of Canadian operations (which are not significant in relation to the accompanying statements) are translated at appropriate exchange rates.

Inventories are stated at the lower of cost (principally retail method) or market.

Property and equipment is stated at cost. Depreciation and amortization is computed generally on the straight-line method based on the estimated service lives of the assets.

The excess of cost of investment in Lerner over related equity which arose from an acquisition prior to October 31, 1970 ($8,720,000 at January 31, 1975 and 1974) has been recognized as being similar in nature to intangibles which have not declined in value since acquisition. In accordance with Accounting Research Bulletin 43, this excess cost is not amortized so long as there is no diminution in value of the related investment (See Note 5).

The excess of cost of investment in Lerner over related equity which arose from an acquisition subsequent to October 31, 1970 ($51,764,000 and $53,075,000, after amortization, at January 31, 1975 and 1974, respectively), is being amortized on a straight-line basis over forty years. (See Note 5).

The flow-through method of accounting is used for investment tax credits.

The companies provide for pension costs each year in an amount equivalent to the actuarially computed current service cost plus amortization of past service cost over a period not exceeding 30 years. It is the general policy to fund pension costs accrued as required.

(2) McCrory Credit Corporation and Equity in Instalment Accounts Sold

McCrory and some of its affiliates have financing agreements with McCrory Credit Corporation under which certain customers' accounts receivable created each month are sold in the following month to McCrory Credit and McCrory Credit remits amounts equal to 90% of the amounts sold, withholding 10% of the uncollected balances representing the companies' equity therein. Under the agreements, the companies repurchase any accounts in default. The 10% equity of McCrory and subsidiaries in sold accounts receivable (the uncollected accounts receivable balances amount to $85,913,000 and $74,347,000, at January 31, 1975 and 1974, respectively) is included in receivables in the consolidated balance sheet. Collections in January (payable to McCrory Credit in February) from sold customers' accounts (net of 10% equity) amounting to $17,620,000 and $17,391,000, respectively, have been deducted from receivables in the accompanying consolidated balance sheet. McCrory Credit's condensed consolidated balance sheet at January 31, 1975 is presented below:

	(In Thousands)
Accounts receivable, less unearned discount	$ 93,122
Cash	12,859
Other assets, less other liabilities	215
	$106,196
Notes payable to banks	$88,350
Subordinated notes payable to Rapid-American Corporation	1,500
McCrory's equity (including $10,400,000 subordinated notes payable)	16,346
	$106,196

Notes payable to banks of McCrory Credit are payable on demand, and as of January 31, 1975 and 1974 the average interest rates were 10.7 and 9.8%, respectively. The maximum amounts of notes payable to banks outstanding at any month-end during the years ended January 31, 1975 and 1974 were $88,700,000 and $82,100,000, respectively. The average amounts of notes payable to banks outstanding during these years were approximately $82,327,000 and $74,550,000, respectively (calculated as the average of the sum of the month-end borrowings outstanding), and the weighted average interest rates on such debt were approximately 10.9 and 8.1%, respectively (calculated by dividing the interest expense during the period for such borrowings by the above average borrowings).

Under informal agreements, it is expected that McCrory Credit maintain cash balances of up to 20% of the lines of credit. These balances are subject to withdrawal at any time. The average monthly cash book balances on deposit with various banks having a credit relationship with McCrory Credit during the year ended January 31, 1975 was approximately $13,761,000. McCrory Credit is presently negotiating a proposed credit agreement with the banks from which it has loans outstanding, which contemplates borrowings of $78,350,000 due January 31, 1976, and the repayment of the $88,350,000 loans outstanding with the proceeds of those borrowings and with funds presently held by certain banks as compensating balances. Interest under the proposed credit agreement will be at the higher of ¼ of 1% over 120% of the prime rate of The Chase Manhattan Bank (National Association) or ¼ of 1% over 130.8% of the commercial paper rate (as defined). In addition, the proposed agreement contemplates a quarterly fee of ⅛ of 1% of the outstanding principal amount of the loans, and a quarterly fee, commencing September 1, 1975, equal to ¼ of 1%, multiplied by the number of quarterly fee payment dates having occurred through the date of payment, of the amount of certain outstanding accounts receivable purchased by McCrory Credit. The borrowings under the proposed agreement will be secured by most of the receivables owned by McCrory Credit. The proposed agreement, which contains certain covenants relating to McCrory Credit's financial position and restricts McCrory Credit from engaging in various transactions, including borrowings, investments, guarantees, business combinations, the payment of dividends and the sale of assets, contemplates that before it is consummated, McCrory Credit will borrow an additional $2,000,000 through the issuance of its subordinated promissory notes. In addition, it is the present intention of management of McCrory that McCrory Credit will significantly curtail its operations by January 31, 1976, that its agreements for the purchase of accounts receivable will terminate on January 31, 1976 and that the subsidiaries and divisions of McCrory that utilize McCrory Credit will make other arrangements for the sale of their receivables. Such other arrangements may involve greater costs to McCrory and its subsidiaries.

McCrory Credit has obtained substantially all its operating funds from unsecured bank borrowings at the prime rate, pursuant to short-term lines of credit. During the year ended January 31, 1975, available short-term lines of credit to McCrory Credit were significantly reduced and certain banks have claimed that McCrory Credit was in default under their notes.

Net income of McCrory Credit for the years ended January 31, 1975 and 1974 of $188,000 and $389,000, respectively, is included in consolidated net income (loss).

(3) Merchandise Inventories

	January 31	
	1975	1974
	(In Thousands)	
Merchandise at stores and warehouses:		
At retail method	$130,214	$175,709
At first-in, first-out cost	21,809	40,495
Merchandise in transit, at warehouses and at restaurants—at identified cost	44,359	41,220
	$196,382	$257,424

(4) J. J. Newberry Co.

As of September 1, 1972, through the merger of its wholly-owned subsidiary with J. J. Newberry Co., McCrory acquired all of the then outstanding common stock of Newberry for an aggregate purchase price of $51,274,000, consisting of 76,792 shares of McCrory common stock and $63,716,000 principal amount (discounted value $49,485,000) of new McCrory 7⅝% sinking fund subordinated debentures due December 15, 1997. This acquisition has been accounted for as a purchase transaction.

McCrory's cost of its investment in Newberry was $23,262,000 less than Newberry's net tangible assets at date of acquisition, which amount was attributed entirely to Newberry's property and equipment and is being amortized (as a reduction of depreciation) over the estimated remaining useful life of 10 years from September 1, 1972. Such amortization amounted to $2,273,000 and $2,326,000, respectively, during the years ended January 31, 1975 and 1974.

During the year ended January 31, 1975, Newberry announced its intention to sell the assets of the Sweet Sixteen Division of J. J. Newberry Canadian Ltd. for approximately the net book value of these assets. This transaction was consummated after January 31, 1975 and the proceeds were received, in cash, during February 1975.

Newberry also closed or disposed of all stores in both the United Division of J. J. Newberry Canadian Ltd. and the Britts Division (Canada) of Britts Dept. Stores Corp. The excess ($1,591,000) of the net book value of fixed assets over the proceeds re-

ceived was applied as a reduction of "excess of Newberry assets acquired over cost." In addition, an aggregate of $1,200,000 relating to the estimated losses on disposition of inventories, the settlement of lease commitments and other costs were charged against the previously established closed store reserve. (See Note 12). The remaining net assets of these operations at January 31, 1975 included in the accompanying consolidated balance sheet is not material.

(5) Lerner Stores Corporation

At February 1, 1973 McCrory owned 60% of the outstanding capital stock of Lerner. On September 18, 1973 (accounted for as of August 1, 1973), a wholly-owned subsidiary of McCrory was merged with Lerner. In connection with the merger, which was accounted for as a purchase transaction in which McCrory was the acquiring corporation: (a) $113,668,000 principal amount (discounted value $72,534,000) of McCrory 7¾% sinking fund subordinated debentures due in 1995 and $18,194,000 in cash were exchanged for all of the outstanding shares of Lerner common stock and substantially all of the outstanding Lerner common stock purchase warrants and (b) the Lerner common treasury stock was cancelled. In addition, $1,484,000 principal amount (discounted value $947,000) of such debentures were issued upon exercise of Lerner warrants. The aggregate cost of McCrory's investment in Lerner exceeded its equity in the underlying net assets at dates of acquisition by $60,484,000 (after amortization of $2,017,000) at January 31, 1975 and $61,795,000 (after amortization of $672,000) at January 31, 1974.

(6) S. Klein Department Stores, Inc.

Management of McCrory decided to phase out completely the operations of S. Klein Department Stores, Inc., a wholly-owned subsidiary of McCrory. While it is not presently possible to determine the ultimate loss to be incurred in connection with such phase-out, a provision of $58,300,000 for the estimated losses to be incurred in phasing out the S. Klein operations (including $6,700,000 relating to the closing of two S. Klein stores as of April 30, 1974), less related deferred Federal income tax benefit of $26,800,000, has been established, based upon various assumptions which management believes are realistic. Such estimated losses consist of the following:

	(In Thousands)
Write-down of assets to net realizable value	$24,126
Present value of future lease commitments (See Note 17), and real estate taxes, net of estimated recoveries	24,110
Other related costs	5,064
Estimated operating losses during phase-out period	5,000
	58,300
Less estimated deferred Federal income tax benefit (See Note 11)	26,800
Estimated losses—net	$31,500

The results of operations of S. Klein for the two years ended January 31, 1975 and the estimated losses provided in the year ended January 31, 1975 for its phase-out have been segregated from continuing operations of McCrory in the accompanying consolidated statement of operations. The results of operations of S. Klein, before allocation of corporate financing and headquarters' administrative expenses, and after giving effect to related income tax benefits, for the two years ended January 31, 1975 are as follows:

	1975	1974
	(In Thousands)	
Revenues	$154,046	$167,200
Costs and expenses	169,764	176,771
Loss before related income tax benefits	(15,718)	(9,571)
Income tax benefits	7,545	4,594
Loss	$ (8,173)	$ (4,977)

In addition, the write-off as at January 31, 1974 of the excess ($11,907,000) of the cost of investment in S. Klein at date of acquisition over the related equity, which management concluded at that date no longer had value, has been reclassified from continuing to discontinued operations in the accompanying consolidated statement of operations for the year ended January 31, 1974. The tax benefit, if any, on such write-off will be recognized if and when realized.

The consolidated balance sheet at January 31, 1975 includes the assets and liabilities related to S. Klein at their estimated realizable values classified as follows:

	Carrying Value	Estimated Loss On Disposal	Estimated Realizable Value
	(In Thousands)		
Net Current Assets Held for Disposal:			
Merchandise inventories...	$17,032	$ 5,290	$11,742
Other current assets—net	2,151	900	1,251
Accounts payable............	(10,506)	—	(10,506)
Total..........................	$ 8,677	$ 6,190	$ 2,487
Net Long-Term Assets Held for Disposal:			
Property and equipment—net	$27,469	$17,836	$ 9,633
Other long-term liabilities—net......................	(80)	100	(180)
Total..........................	$27,389	$17,936	$ 9,453

In addition, included in the reserve for store closings at January 31, 1975 are $14,558,000 (current), exclusive of $75,000 rental expense of the two Klein stores closed in 1974, and $19,541,000 (long-term) applicable to the estimated losses arising from the phase-out of S. Klein.

The accompanying consolidated balance sheet at January 31, 1974 has not been restated and includes the assets and liabilities of S. Klein at their carrying value and in their original classification since the applicable amounts are not material.

(7) Rapid-American Corporation (Parent Company)

McCrory owned at January 31, 1975 and 1974, 77,684 shares of Rapid-American Corporation common stock and 155,368 redeemable warrants (expiring May 15, 1994) to purchase Rapid common stock at $35 per share. The common stock and warrants had aggregate market quotation values of $777,000 and $1,942,000 at January 31, 1975 and 1974, respectively. Because of the continued depressed quoted market prices of the Rapid common stock and warrants, McCrory management wrote-down such investment to $1,621,000 (the average quoted market prices for these securities over the last four years) giving rise to a loss of $2,000,000. No tax benefit has been recognized on such write-off since, for Federal income tax purposes, the write-off is considered a capital loss and the benefit, if any, is not realizable beyond a reasonable doubt. (See Note 19).

(8) Long-Term Receivable

McCrory is to receive $593,000 per year in payment of the long-term receivable aggregating $10,736,000 (principal amount), which was discounted at an interest rate of 5% per annum.

(9) Long-Term Debt

The aggregate of long-term debt (see accompanying schedule) maturing during the five years ending January 31, 1980 is approximately as follows: 1976, $2,862,000 (included in current liabilities); 1977, $68,916,000; 1978, $2,784,000; 1979, $2,786,000; and 1980, $5,866,000. The year 1977 includes $52,000,000 of notes payable to lenders under the Credit Agreement.

The Credit Agreement requires McCrory to maintain a consolidated tangible net worth (as defined) plus subordinated indebtedness (as defined) of not less than $185,000,000. McCrory is further required to maintain consolidated net current assets (as defined) of not less than $130,000,000 on January 31, 1975 and 1976, and not less than $115,000,000 at all other times. McCrory also must maintain a ratio of consolidated current assets (as defined) to consolidated current liabilities (as defined) of not less than 1.80 to 1 on January 31, 1975 and 1976, and of not less than 1.50 to 1 at all other times. McCrory is required to reduce to $52,000,000 its aggregate borrowings under the Credit Agreement for a 30-day period during the last two months of each of its fiscal years in which the loans are outstanding. Since the Credit Agreement was entered into, it has been amended and the lenders, on several occasions, have waived compliance with certain of its covenants. McCrory believes that by July 1, 1975 it may be necessary to renegotiate, or extend the term of, the Credit Agreement.

The Credit Agreement and other agreements covering certain indebtedness contain certain material restrictions on McCrory and its subsidiaries including restrictions on indebtedness, liens, guarantees, lease commitments, capital expenditures, the disposition of property, investments and the right to engage in business combinations. At January 31, 1975, under the most restrictive provisions of such agreements, McCrory was not entitled to pay dividends on its common stock. Unrestricted earnings (as defined) available for payment of dividends on McCrory's preferred stocks under the Credit Agreement pursuant to a waiver granted by the lenders amounted to $4,581,000 as at January 31, 1975. Furthermore, the Credit Agreement restricts the amount of McCrory's indebtedness to Lerner; provided however, that the aggregate amount of future Lerner loans and advances to McCrory are limited to

the amounts of future dividends (as defined) which may be declared by Lerner.

Newberry's Sinking Fund and Subordinated Notes, supplemental agreements and indentures contain certain covenants restricting the amount of retained earnings available for the payment of cash dividends or for acquisition of Newberry's capital stock at January 31, 1975. Because of such restrictions, there were no retained earnings available for payment of common stock dividends.

In addition, the dividend on Newberry's preferred stock, which would have been declared by Newberry on or about April 15, 1975 was passed because such a declaration is prohibited by a covenant under one of the indentures which restricts payment of cash dividends when required retained earnings (as defined) is not maintained.

(10) Significant Additional Information Relating to the Consolidated Statement of Operations

Interest expense for the year ended January 31, 1975 has been reduced by a gain in the amount of $2,319,000 on the purchase of subordinated debt to satisfy present and future sinking fund payments. Gains on similar purchases for the year ended January 31, 1974 were not material.

Selling, advertising, general and administrative expenses for the year ended January 31, 1974 include the following:

	(In Thousands)
Severance pay to former chief executive officer (net of reserves)	$1,421
Charge for estimated costs in connection with proposed (but not consummated) sale of certain divisions	$1,500
Credit resulting from reduction of reserve for store closing programs as a result of reappraisal (See Note 12)	$(1,915)

Costs of $3,163,000 incurred in the year ended January 31, 1974 in converting Newberry to the McCrory system of buying, merchandising and traffic control and developing a new warehousing and traffic system, have been classified as deferred systems development costs (included in sundry assets) and are being amortized over five years. The remaining unamortized balance at January 31, 1975 aggregates $2,051,000 and is net of $515,000 charged to expense in the year ended January 31, 1975 in excess of normal amortization.

(11) Federal Income Taxes

Deferred tax expense results from the recognition of revenue and expense items in different periods for tax and financial statement purposes. The sources of these differences from continuing operations and the tax effect of each were as follows:

	Year Ended January 31 1975	Year Ended January 31 1974
	(In Thousands)	
Excess of tax over book depreciation	$ 376	$1,766
Use of installment method of reporting certain sales for income tax purposes	960	716
Reduction in reserve for store closing programs	1,617	1,340
Deferred systems development costs	(534)	1,440
Other items	(562)	(631)
	$1,857	$4,631

The following is a reconciliation of the provision for Federal income taxes using the applicable statutory tax rate, with the Federal income tax expense shown in the consolidated statement of operations:

	Year Ended January 31 1975	Year Ended January 31 1974
	(In Thousands)	
Income from continuing operations before Federal income taxes and minority interest	$5,233	$38,160
Income tax provision computed at Federal statutory rate	$2,512	$18,317
Increase (reduction) in Federal income taxes resulting from:		
Amortization of excess of equity over cost of related investment not taxable	(1,091)	(1,117)
Provision for loss on investments	960	—
Amortization of excess of cost of investment over related equity not deductible for tax purposes	646	323
Investment tax credit	—	(949)
Other	(375)	(65)
Federal income tax provision at effective rate	$2,652	$16,509

Investment tax credits of $949,000 in the year ended January 31, 1974 were applied as a reduction of the current tax provision. No such tax credit was applied for the year ended January 31, 1975.

McCrory has an estimated net operating loss carryforward of approximately $17,000,000 at January 31, 1975 which will expire in the year ending January 31, 1980. In addition, estimated operating

losses of approximately $58,000,000 are expected to result from the phase-out of the S. Klein operations. The principal portion of these losses is expected to be reported for Federal income tax purposes during the three years ending January 31, 1978 and accordingly, will be available to reduce taxable income, for the most part, through January 31, 1983, with additional amounts being reported in years subsequent to January 31, 1978.

As of January 31, 1975, McCrory recorded $17,488,000 (in addition to reversals of previously recorded net deferred tax credits of $15,000,000, which is the estimated amount of such credits expected to reverse within the next five years) as estimated future deferred Federal income tax benefits, resulting principally from the operating losses, and the provision for losses on the phase-out, of S. Klein reported in the year ended January 31, 1975 (See Note 6). In the opinion of management, realization of such amount is assured beyond a reasonable doubt because of McCrory's ability to generate sufficient future taxable income through operations and other sources to offset the loss carryforwards.

Certain Canadian subsidiaries have net operating loss carryforwards approximating $1,000,000 which will expire in the year ending January 31, 1976. The tax benefits of such loss carryforwards will be recognized if and when realized.

(12) Reserve for Store Closing Programs

(A) S. Klein Department Stores, Inc.

See Note 6 for information regarding a reserve for store closing established for the phase-out of S. Klein.

(B) J. J. Newberry Co.

The reserve for store closing programs represents estimated losses, including payments under existing leases (less estimated subrental income), as determined by Newberry prior to the date of acquisition, in connection with its programs to close certain unprofitable stores. Such losses applicable to closed stores ($3,369,000 for the year ended January 31, 1975, and $887,000 for the year ended January 31, 1974) have been charged against the reserve as incurred. As a result of periodic reappraisal by management, the reserve was reduced by $1,915,000 (credited to selling, advertising, general and administrative expenses) in January 1974 (See Note 10). All related store operations are included in the consolidated statement of operations until the stores are closed. It is estimated that the programs covered by the Newberry reserve will be completed over the next three years.

(13) Pension Plans

McCrory and its subsidiaries have several pension plans, covering certain of their employees. For the years ended January 31, 1975 and 1974 pension costs (including costs applicable to discontinued operations) amounted to $2,103,000 and $1,901,000, respectively. In August, 1974, retroactively to January 1, 1974, the Newberry pension plan was amended, restated and merged with respect to all eligible employees so as to be identical with the pension plan of McCrory. The amendment increased pension costs $245,000 in the year ended January 31, 1975. During the year ended January 31, 1974 the actuarial investment rate assumption used in computing pension cost was changed, resulting in a decrease in pension cost of approximately $650,000. Unfunded past service costs amounted to approximately $5,617,000 at January 31, 1975.

Effective January 1, 1976 McCrory and its subsidiaries will be required to comply with the participation, vesting and funding requirements of the Employee Retirement Income Security Act of 1974. Based upon preliminary estimates, it appears likely that compliance will not have the effect of substantially increasing the amount of periodic provision for pension expense, periodic funding of pension costs and unfunded vested benefits; however, final determination of such effect will not be available until the necessary actuarial computations have been completed.

(14) Preferred and Preference Stock and Common Stock Purchase Warrants

At January 31, 1975, 157,109 shares of $100 par value preferred and preference stock were outstanding (aggregate par value $15,711,000; aggregate redemption amount $17,136,000), as follows:

Class of Stock	Shares: Authorized	Shares: Outstanding	Redemption Price	Conversion Rate	Common Shares Reserved
3½% preferred	1,129	1,129	$104	5 for 1	5,645
$6 preference	94,725	94,725	115	3/14 for 1	20,298
5½% preference B	1,824	1,292	100	—	—
4½% preference B	60,201	59,963	100	—	—
		157,109			25,943

At January 31, 1975 there were outstanding warrants (expiring March 15, 1976) to purchase

74,905 McCrory common shares at $20 per share; warrants (expiring March 15, 1981) to purchase 471,997 McCrory common shares at $20 per share through March 15, 1976 and thereafter at $22.50 per share; and warrants (expiring October 1, 1981) to purchase 122,824 McCrory common shares at $65.64 per share.

(15) Stock Option and Stock Bonus Plans

The following summarizes the common stock option activity for the year ended January 31, 1975:

	1964 Plan	1967 Plan	Other*
Option price range	$13.625	$16.50-32.625	$12.64-20.71
		Shares	
Outstanding February 1, 1974	21,400	10,625	89,914
Cancelled	—	(6,250)	(8,642)
Outstanding January 31, 1975	21,400	4,375	81,272
Additional shares available for granting of options at January 31, 1975	—	109,379	—

* Substituted for outstanding options granted under Lerner stock option plans.

At January 31, 1975, 53,981 McCrory shares were available for allocation under stock bonus plans. The excess of market value of such shares on the date of allocation over the par value thereof is being charged to income ratably over periods not exceeding eight years from date of issuance.

(16) Earnings Per Share of Common Stock

Primary earnings per share is based on the weighted average number of common shares outstanding during each year. Fully diluted earnings per share has been computed assuming conversion of all convertible securities when the effect would be dilutive. This calculation also assumes the issuance of additional common shares on exercise of stock options and warrants with a portion of the proceeds used to acquire common stock and the balance used to reduce outstanding debt.

Reported income per share assuming full dilution cannot exceed primary income per share. For the year ended January 31, 1975, the above-mentioned assumed conversion of convertible securities and exercise of stock options and warrants resulted in anti-dilution; accordingly, income (loss) per share assuming full dilution, has not been presented on the consolidated statement of operations.

(17) Lease Commitments

McCrory operates principally in leased premises. The basic terms of the leases generally range from 10 to 30 years and provide for the payment of additional rentals based upon percentages of sales, plus in certain instances, real estate taxes, insurance and maintenance. Many of the leases meet the criteria of non-capitalized financing leases as defined by the Securities and Exchange Commission.

Rent expense, net of minor sublease income, is as follows:

	Year Ended January 31	
	1975	1974
	(In Thousands)	
Basic rents:		
Non-capitalized financing leases	$33,217	$33,679
Other	40,461	38,904
Contingent rents	10,512	9,515
Total	$84,190	$82,098
Continuing operations	$75,313	$72,720
Discontinued operations	8,877	9,378
Total	$84,190	$82,098

The minimum rental commitments, net of minor sublease income, in effect at January 31, 1975 are as follows:

Periods Ending January 31	Financing Leases: Continuing Operations	Financing Leases: Discontinued Operations	Total(a)
	(In Thousands)		
1976	$ 24,747	$ 7,983	$ 63,988
1977	24,075	7,897	61,545
1978	23,410	7,785	59,125
1979	22,938	7,785	57,159
1980	22,420	7,778	55,130
1976-1980	117,590	39,228	296,947
1981-1985	93,261	38,591	237,496
1986-1990	55,289	29,824	158,338
1991-1995	27,696	21,279	80,752
Thereafter	22,472	13,397	45,595
Total	$316,308	$142,319	$819,128

(a) Includes non-financing leases.

Total minimum rental commitments, total and present values of non-capitalized financing lease commitments, and the range and weighted average of interest rates used in computing present values of financing lease commitments are as follows:

	Continuing Operations			
	Real Property	Equipment and Fixtures	Discontinued Operations	Total
	(In Thousands)			
January 31, 1975				
Total minimum rental commitments	$659,725	$17,084	$142,319	$819,128
Total non-capitalized financing lease commitments	299,224	17,084	142,319	458,627
Present values of non-capitalized financing lease commitments	186,080(a)	13,768	76,199	276,047
Range of interest rates used in computing present values	4.7% to 10.8%	5.0% to 6.5%	3.5% to 10.0%	3.5% to 10.8%
Weighted average interest rates used in computing present values	6.16%	5.79%	7.05%	6.43%
January 31, 1974				
Total minimum rental commitments	687,837	20,637	157,254	865,728
Total non-capitalized financing lease commitments	326,459	20,032	157,254	503,745
Present values of non-capitalized financing lease commitments	194,242(a)	15,786	82,089	292,117
Range of interest rates used in computing present values	4.7% to 9.5%	5.0% to 6.5%	3.5% to 10.5%	3.5% to 10.5%
Weighted average interest rates used in computing present values	5.97%	5.78%	6.78%	6.19%

(a) Determination of real estate taxes was not practicable.

If all leases identified as non-capitalized financing leases had been capitalized, the effect on net income (loss) would have been as follows:

	Year Ended January 31	
	1975	1974
	(In Thousands)	
Increase in amortization expense	$16,049	$16,469
Increase in interest expense	17,911	18,806
Decrease in lease rental expense	(33,217)	(33,679)
Net increase in expense	743	1,596
Decrease in income tax provision	357	766
Decrease in net income	$ 386	$ 830
Decrease in net income from continuing operations	$ 79	$ 382
Increase in net loss from discontinued operations	307	448
Total	$ 386	$ 830

(18) Other Commitments and Contingencies

There are claims pending against McCrory and its subsidiaries. Management, based upon opinions of counsel, is of the opinion that the ultimate liability, if any, will not materially affect the business or the consolidated financial position of McCrory and its subsidiaries. (See also Note 17).

(19) Other Significant Events

In March and April of 1975, the Boards of Directors of McCrory and Rapid, respectively, announced that they had approved in principle a merger of McCrory with a wholly-owned subsidiary of Rapid pursuant to which holders of common stock of McCrory would receive one-half of a share of Rapid common stock for each share of McCrory common stock.

The merger is subject to a number of conditions, including consent of bank lenders to both companies, the execution of a definitive agreement between the parties and stockholder approval.

On April 29, 1975, Rapid's Board of Directors authorized a proposed additional investment of approximately $40,000,000 in McCrory. This investment is contemplated to be in the form of a subordinated note, junior to all trade debt, and convertible into a redeemable junior preferred stock. The investment is subject to approval of Rapid and McCrory bank lenders. The issuance of the junior preferred stock is also subject to the approval of the McCrory stockholders.

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

TWO BROADWAY
NEW YORK, NEW YORK 10004

AUDITORS' OPINION

The Board of Directors and Stockholders of
McCrory Corporation:

We have examined the consolidated financial statements of McCrory Corporation and subsidiary companies for the years ended January 31, 1975 and 1974. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Lerner Stores Corporation and its subsidiaries, which statements reflect total assets constituting 29% and 26%, respectively, of consolidated total assets at January 31, 1975 and 1974 and revenues constituting 36% and 33%, respectively, of consolidated revenues (including revenues of discontinued operations) for the years then ended. These statements were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Lerner Stores Corporation and its subsidiaries, is based solely upon such report of the other auditors.

Our opinion dated April 24, 1974, with respect to the consolidated financial statements of McCrory Corporation and subsidiary companies for the year ended January 31, 1974 was qualified subject to the success of management's program to improve the operating results of S. Klein Department Stores, Inc. As discussed in Note 6, management has decided to phase out completely the operations of S. Klein and has provided $31,500,000, after related deferred Federal income tax benefits, for the estimated losses expected to be incurred in such phase-out. This provision is based upon various assumptions which management believes are realistic, but the ultimate loss is dependent upon future events.

In our opinion, subject to adjustments, if any, which may result from the ultimate resolution of the matter referred to in the preceding paragraph and based upon our examination and the report of other auditors referred to above, the accompanying consolidated balance sheet and consolidated statements of operations, stockholders' equity and changes in financial position present fairly the financial position of McCrory Corporation and subsidiary companies at January 31, 1975 and 1974 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Haskins & Sells

April 30, 1975

PER SHARE MARKET PRICES AND DIVIDEND INFORMATION

The high and low sales prices and quarterly dividends paid (see Note 9 to Notes to Consolidated Financial Statements) for McCrory Corporation Common Stock traded on the New York Stock Exchange (trading symbol: MS) during the past two fiscal years were as follows:

	YEAR ENDED JANUARY 31,					
	1975			1974		
	Market Price		Dividends Paid	Market Price		Dividends Paid
	High	Low		High	Low	
Common Stock						
1st Quarter	16⅛	14¼	$.30	25	22⅜	$ .30
2nd Quarter	15⅝	6	.30	22⅞	16½	.30
3rd Quarter	7½	4¾	.30	19¾	16⅞	.30
4th Quarter	6	2	—	17¼	12⅜	.30
For the Year	16⅛	2	$.90	25	12⅜	$1.20

There have not been any bid or asked quotations for the 5½% Cumulative Preference B Stock of McCrory Corporation in the over-the-counter market during the two fiscal years ended January 31, 1975. Dividends of $1.375 per share have been paid in each quarter of the two fiscal years ended January 31, 1975.

Five Year Summary of Operations

	Year Ended January 31				
	1975	1974	1973(a)	1972	1971
	(In Thousands, Except Per Share Amounts)				
Revenues	$1,286,139	$1,261,465	$1,043,355	$765,943	$722,133
Costs and expenses	1,230,928	1,186,657	973,286	710,509	669,462
Interest and debt expense	45,393	33,896	18,999	14,696	16,428
Federal and state income taxes	5,237	19,261	23,179	18,632	16,720
Minority interest	—	3,166	8,606	6,769	5,857
	1,281,558	1,242,980	1,024,070	750,606	708,467
Income from continuing operations before item set forth below	4,581	18,485	19,285	15,337	13,666
Provision for loss on investments	2,000	—	—	—	—
Income from continuing operations	2,581	18,485	19,285	15,337	13,666
Income (loss) from discontinued operations	(39,673)	(16,884)	(1,772)	64	470
Net income (loss)	(37,092)	1,601	17,513	15,401	14,136
Consolidated preferred dividend requirements	1,145	1,160	959	851	879
Net income (loss) applicable to common stock	$ (38,237)	$ 441	$ 16,554	$ 14,550	$ 13,257
Earnings (loss) per share of common stock:					
Primary:					
Continuing operations	$ .28	$ 3.42	$ 4.59	$3.41	$2.88
Discontinued operations	(7.83)	(3.33)	(.44)	.02	.11
Net income (loss)	$ (7.55)	$ .09	$ 4.15	$3.43	$2.99
Fully diluted:					
Continuing operations	*	$ 3.17	$ 3.20	$2.33	$2.34
Discontinued operations	*	(3.15)	(.31)	.01	.09
Net income (loss)	*	$ .02	$ 2.89	$2.34	$2.43

(a) Operations of J. J. Newberry Co. are included from date of acquisition, September 1, 1972.
* Anti-dilutive

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

General

During the past five fiscal years there have been a significant number of material developments relating to McCrory's business and corporate structure, including acquisitions, dispositions and business combinations, which have had a material effect on operations.

McCrory's results of consolidated operations in its last two fiscal years were materially affected (i) in the year ended January 31, 1975, by a provision for estimated losses to be incurred in connection with the phase-out of discontinued operations related to S. Klein, (ii) in the prior year, by a write-off of excess of cost of investment over related equity of S. Klein and (iii) in both years (and in the year ended January 31, 1973), by operating losses (included in results of discontinued operations) incurred by S. Klein. See Note 6 to Notes to Consolidated Financial Statements.

The decrease in income from continuing operations for the year ended January 31, 1975 compared to the prior year resulted primarily from (i) the increased cost of doing business caused by inflationary pressures as well as general economic conditions which caused, in part, heavier than normal markdowns, particularly in the Variety Stores and Britts Department Stores Divisions, where declines in sales were experienced; (ii) increased interest and debt expense, principally because of higher interest rates and higher debt levels; and (iii) the provision for loss on investments in securities of Rapid-American because of continued depressed quoted market prices. The higher debt level stemmed in part from the debt issued in connection with the elimination of the minority interest in Lerner, which substantially offset the interest and debt expense related to that debt. Interest expense for the year ended January 31, 1975 was reduced by a gain of $2,319,000 on the purchase of subordinated debt to satisfy present and future sinking fund payments. Gains on similar purchases in the prior year were not material. Depreciation was reduced during the three years ended January 31, 1975 by $965,000, $2,326,000 and $2,273,000, respectively, as a result of the amortization of the excess credit arising in connection with the Newberry acquisition. See Note 4 to Notes to Consolidated Financial Statements.

In the year ended January 31, 1975, (i) net sales of leased departments increased primarily from rentals from additional concessions which were opened in the Britts Department Stores and (ii) maintenance and repair expenses increased primarily due to higher costs.

The decrease in income from continuing operations for the year ended January 31, 1974 compared to the prior year resulted principally from (i) the inclusion of the results of operations of Newberry for the full year compared to its inclusion for only five months in the prior year and (ii) higher interest and debt expense due to higher interest rates and debt levels. The increased debt level arose from (a) the inclusion of the costs of acquiring Newberry for twelve months in the year ended January 31, 1974 compared to only five months in the prior year and (b) the debt issued in the acquisition (as of August 1, 1973) of the minority interest in Lerner. The reduction of the minority interest in the net income of Lerner more than offset the interest and debt expense on the debt issued in that acquisition.

The increases in revenues and expenses during the two years ended January 31, 1973 and 1974 were primarily attributable to the operations of Newberry, which was acquired in September 1972. See Note 4 to Notes to Consolidated Financial Statements.

The increase in net income from continuing operations for the year ended January 31, 1973 compared to the prior year resulted principally from the acquisition of Newberry on September 1, 1972. Due to the seasonal nature of Newberry's business and the date of its acquisition, Newberry's contribution to McCrory's earnings was included only for its most profitable five-month period.

CORPORATE INFORMATION

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10-K REPORT McCrory Corporation's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, is available to stockholders free of charge upon written request to:

Corporate Secretary
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888 Seventh Avenue,
New York, New York 10019